

recovered, equals or exceeds 25 percent of the cost of the injectant.

(4) *Hydrocarbon defined.* For purposes of section 193 and this section, the term *hydrocarbon* means all forms of natural gas and crude oil (which includes oil recovered from sources such as oil shale and condensate).

(5) *Injectant defined.* For purposes of applying this paragraph (c), an injectant is the substance or mixture of substances injected at a particular time. Substances injected at different times are not treated as components of a single injectant even if the injections are part of a single tertiary recovery process.

(d) *Application with other deductions.* No deduction shall be allowed under section 193 and this section for any expenditure:

(1) With respect to which the taxpayer has made an election under section 263(c) or

(2) With respect to which a deduction is allowed or allowable under any other provision of chapter 1 of the Code.

(e) *Examples.* The application of this section may be illustrated by the following examples:

Example 1. B, a calendar year taxpayer who uses the cash receipts and disbursements method of accounting, uses an approved tertiary recovery method for the enhanced recovery of crude oil from one of B's oil properties. During 1980, B pays \$100x for a tertiary injectant which contains 1,000y units of hydrocarbon; if separated from the other components of the injectant before injection, the hydrocarbons would have a fair market value of \$80x. B uses this injectant during the recovery effort during 1981. B has not made any election under section 263(c) with respect to the expenditures for the injectant, and no section of chapter 1 of the Code other than section 193 allows a deduction for the expenditure. B is unable to demonstrate that the value of the injected hydrocarbons recovered during production will be less than \$80x. B's deduction under section 193 is limited to the excess of the cost for the injectant over the fair market value of the hydrocarbon component expected to be recovered (\$100x - \$80x = \$20x). B may claim the deduction only for 1981, the year of the injection.

Example 2. Assume the same facts as in *Example 1* except that through engineering studies B has shown that 700y units or 70 percent of the hydrocarbon injected is non-recoverable. The recoverable hydrocarbons have a fair market value of \$24x (30 percent of \$80x). The recoverable hydrocarbon por-

tion of the injectant is 24 percent of the cost of the injectant (\$24x divided by \$100x). The injectant does not contain a significant amount of recoverable hydrocarbons. B may claim a deduction for \$100x, the entire cost of the injectant.

Example 3. Assume the same facts as in *Example 1* except that through laboratory studies B has shown that because of chemical changes in the course of production the injected hydrocarbons that are recovered will have a fair market value of only \$40x. B may claim a deduction for \$60x, the excess of the cost of the injectant (\$100x) over the fair market value of the recoverable hydrocarbons (\$40x).

Example 4. B prepares an injectant from crude oil and certain non-hydrocarbon materials purchased by B. The total cost of the injectant to B is \$100x, of which \$24x is attributable to the crude oil. The fair market value of the crude oil used in the injectant is \$27x. B is unable to demonstrate that the value of the crude oil from the injectant that will be recovered is less than \$27x. The injectant contains more than an insignificant amount of recoverable hydrocarbons because the value of the recoverable crude oil (\$27x) exceeds \$25x (25 percent of \$100x, the cost of the injectant). Because the cost to B of the hydrocarbon component of the injectant (\$24x) is less than the fair market value of the hydrocarbon component in the form in which it is recovered (\$27x), the cost rather than the value is taken into account in the adjustment required under paragraph (c)(1) of this section. B's deduction under section 193 is limited to the excess of the cost of the injectant over the cost of the hydrocarbon component (\$100x - \$24x = \$76x).

(Secs. 193 and 7805, Internal Revenue Code of 1954, 94 Stat. 286, 26 U.S.C. 193; 68A Stat. 917, 26 U.S.C. 7805)

[T.D. 7980, 49 FR 39052, Oct. 3, 1984]

§ 1.194-1 Amortization of reforestation expenditures.

(a) *In general.* Section 194 allows a taxpayer to elect to amortize over an 84-month period, up to \$10,000 of reforestation expenditures (as defined in § 1.194-3(c)) incurred by the taxpayer in a taxable year in connection with qualified timber property (as defined in § 1.194-3(a)). The election is not available to trusts. Only those reforestation expenditures which result in additions to capital accounts after December 31, 1979 are eligible for this special amortization.

(b) *Determination of amortization period.* The amortization period must begin on the first day of the first

month of the last half of the taxable year during which the taxpayer incurs the reforestation expenditures. For example, the 84-month amortization period begins on July 1 of a taxable year for a calendar year taxpayer, regardless of whether the reforestation expenditures are incurred in January or December of that taxable year. Therefore, a taxpayer will be allowed to claim amortization deductions for only six months of each of the first and eighth taxable years of the period over which the reforestation expenditures will be amortized.

(c) *Recapture.* If a taxpayer disposes of qualified timber property within ten years of the year in which the amortizable basis was created and the taxpayer has claimed amortization deductions under section 194, part or all of any gain on the disposition may be recaptured as ordinary income. See section 1245.

[T.D. 7927, 48 FR 55849, Dec. 16, 1983]

§ 1.194-2 Amount of deduction allowable.

(a) *General rule.* The allowable monthly deduction with respect to reforestation expenditures made in a taxable year is determined by dividing the amount of reforestation expenditures made in such taxable year (after applying the limitations of paragraph (b) of this section) by 84. In order to determine the total allowable amortization deduction for a given month, a taxpayer should add the monthly amortization deductions computed under the preceding sentence for qualifying expenditures made by the taxpayer in the taxable year and the preceding seven taxable years.

(b) *Dollar limitation—(1) Maximum amount subject to election.* A taxpayer may elect to amortize up to \$10,000 of qualifying reforestation expenditures each year under section 194. However, the maximum amortizable amount is \$5,000 in the case of a married individual (as defined in section 143) filing a separate return. No carryover or carryback of expenditures in excess of \$10,000 is permitted. The maximum annual amortization deduction for expenditures incurred in any taxable year is \$1,428.57 (\$10,000/7). The maximum deduction in the first and eighth taxable

years of the amortization period is one-half that amount, or \$714.29, because of the half-year convention provided in § 1.194-1(b). Total deductions for any one year under this section will reach \$10,000 only if a taxpayer incurs and elects to amortize the maximum \$10,000 of expenditures each year over an 8-year period.

(2) *Allocation of amortizable basis among taxpayer's timber properties.* The limit of \$10,000 on amortizable reforestation expenditures applies to expenditures paid or incurred during a taxable year on all of the taxpayer's timber properties. A taxpayer who incurs more than \$10,000 in qualifying expenditures in connection with more than one qualified timber property during a taxable year may select the properties for which section 194 amortization will be elected as well as the manner in which the \$10,000 limitation on amortizable basis is allocated among such properties. For example, A incurred \$10,000 of qualifying reforestation expenditures on each of four properties in 1981. A may elect under section 194 to amortize \$2,500 of the amount spent on each property, \$5,000 of the amount spent on any two properties, the entire \$10,000 spent on any one property, or A may allocate the \$10,000 maximum amortizable basis among some or all of the properties in any other manner.

(3) *Basis—(i) In general.* Except as provided in paragraph (b)(3)(ii) of this section, the basis of a taxpayer's interest in qualified timber property for which an election is made under section 194 shall be adjusted to reflect the amount of the section 194 amortization deduction allowable to the taxpayer.

(ii) *Special rule for trusts.* Although a trust may be a partner of a partnership, income beneficiary of an estate, or (for taxable years beginning after December 31, 1982) shareholder of an S corporation, it may not deduct its allocable share of a section 194 amortization deduction allowable to such a partnership, estate, or S corporation. In addition, the basis of the interest held by the partnership, estate, or S corporation in the qualified timber property shall not be adjusted to reflect the portion of the section 194 amortization deduction that is allocable to the trust.